No. 12-562

In the Supreme Court of the United States

UNITED STATES,

Petitioner,

v.

GARY WOODS, as Tax Matters Partner of Tesors Drive Partners, et al.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF *AMICI CURIAE* GORDON W. BUSH, ET AL. IN SUPPORT OF RESPONDENT

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INTEREST OF THE *AMICI CURIAE*[1]

Amici are the taxpayers listed in Addendums A-D, Kenneth A. Kercher, Suzanne B. Kercher, Alfonso Varela, Sandra Santa Maria Varela, and Charles Mangum. Each is a party to one of the following (collectively "*amici*'s suits"):

- *Bush, et. al v. United States* (Fed.Cir. 12-5051), petition pending for rehearing and rehearing *en banc* regarding 2013 U.S.App.LEXIS 10879 (Fed. Cir. 2013);
- *Kercher, et ux v. United States* (5th Cir. 12-40483), appeal pending from 2010 U.S. Dist. LEXIS 121259 (E.D.Tex. 2010) and 2012 U.S. Dist. LEXIS 34600 (E.D.Tex. 2012);
- *Varela, et ux v. United States* (5th Cir. 12-20359), appeal pending from 2011 U.S. Dist. LEXIS 58621 (S.D. Tex. 2011), and 2012 U.S. Dist. LEXIS 73897 (S.D. Tex. 2012);
- *Irvine, et. al v. United States* (5th Cir. 12-20523), appeal pending from 2012 U.S. Dist. LEXIS 60083 (S.D. Tex. 2012);
- *Acute Care Specialists II, Ltd., et. al v. United States* (7th Cir. 12-1212), appeal pending from 2011 U.S. Dist. LEXIS 144155 (N.D. 2011);

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[1] This brief is filed with the written consent of both parties. Supreme Court Rule 37.3(a). *Amici* certify that this brief was not authored in whole or in part by counsel for either party and that *amici* received no monetary contribution toward the preparation or submission of this brief. Supreme Court Rule 37.6.

- *Fillmore Equip. of Holland, Inc., et. al v. United States* (Fed.Cir. 13-5048), petition for a writ of certiorari to the Federal Circuit anticipated to be filed shortly regarding 2013 U.S. App. LEXIS 12511 (Fed. Cir. 2013); and
- *Mangum v. Commissioner* (T.C. 1288-12), 26 U.S.C. §6330 appeal from a collection due process (CDP) hearing pending before the Tax Court.

The Court instructed the parties to brief the jurisdictional character and scope of 26 U.S.C. §6226.[2] Claims in each *amici* suit turn on that issue. While both the United States and Woods assume, without analysis, that §6226(f) is jurisdictional, some courts treat §6226 provisions as nonjurisdictional and subject to waiver or alteration.[3] *Amici* urge the Court to establish and apply the *test* that determines the jurisdictional character of tax statutes, rather than simply assuming that character.

Other issues in this case that, if addressed or assumed, will directly impact the *amici*'s suits include whether:

- the 1997 amendments to §6226 provisions apply for all tax years;
- a statute's jurisdictional character applies to its

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[2] *United States v. Woods*, 133 S. Ct. 1632, 185 L. Ed. 2d 615 (2013).

[3] For example, see *Prati v. United States*, 603 F.3d 1301, 1307-08 and n.4 (Fed.Cir. 2010) (endorsing the Tax Court's waiver of pre-1997 §6226(d)(1)(B)).

effective date;

- the statutory definition of "partnership item" may be judicially expanded to encompass "affected items" on the rationale that, but for partnership items, there would be no affected items;
- the undefined term "attributable to" mandates a direct causal link or whether an indirect, second-hand, or one-step-removed relationship will suffice for tax statutes; and
- the phrase "relates to *an adjustment to* a partnership item" in §6226(f) may be read as "relates to a partnership item."

TEFRA is not limited only to partnerships that may be tax shelters. This Court's jurisdictional holding will directly impact virtually every partner in every TEFRA partnership. It will be especially felt by the thousands of small investors who, like *amici*, were limited partners and now find themselves penalized due entirely to partnership-level actions taken without their knowledge and in which they, as limited partners, could not participate.

Here, the United States attacks the Fifth Circuit's application of the "Blue Book" formula that determines the portion of an underpayment subject to the §6662 penalty. *Amici* suits involve the "penalty" rate of interest under former §6621(c). The government has attempted to use questions regarding that Blue Book formula to undermine the Internal Revenue Service's (IRS's) similar formula formally promulgated and adopted in Treas.Reg. §301.6621-2T, A-5, which determines the portion of an underpayment subject to

penalty interest.[4] The Fifth and Federal Circuits are split on whether the Secretary is required to apply its own regulation.[5] This Court's resolution of how to determine the portion of an underpayment subject to the §6662 penalty is anticipated to directly impact *amici*'s penalty interest cases.

SUMMARY OF THE ARGUMENT

Arbaugh and *Henderson* establish the general test for jurisdictional character of all federal statutes, including tax, unless a specific test applies.[6] No specific test applies to §6226. Under *Arbaugh*/*Henderson*, §6226 provisions (except subsection (h)), the effective dates of their 1997 amendments, and §6233 (to the extent it impacts partnership-level suits) are jurisdictional.

To the extent provided by regulation, §6233 imposes TEFRA §6221 *et seq*. partnership provisions on any entity that files a partnership return, its items,

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[4] See the Brief for the Appellee pp. 62-63, n. 14 (Doc. 00512139781, Feb. 8, 2013) filed in *Irvine*.

[5] *Weiner v. United States*, 389 F.3d 152, 159-163 (5th Cir. 2004), (where an underpayment is attributable to two independent, separable grounds, one supporting penalty interest and one not, under Treas.Reg. §301.6621-2T, A-5, the portion subject to penalty interest is 0 (100% - 100% = 0); *Prati*, 603 F.3d at 1308 (in that same scenario, applying Treas.Reg. §301.6621-2T, A-5 "would invalidate the determination" that supports penalty interest).

[6] *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 546, 126 S. Ct. 1235, 163 L. Ed. 2d 1097 (2006); *Henderson v. Shinseki*, 131 S. Ct. 1197, 179 L. Ed. 2d 159 (2011).

and persons holding an interest in such entity, regardless of whether the entity is a partnership and even if it is determined that there is no entity. Neither the Internal Revenue Code nor regulations, however, make clear how to apply §6233 once a court determines the partnership is a "sham" to be disregarded for tax purposes.

As relevant, the scope of §6226(f) partnership-level jurisdiction for tax year 1999 is limited to adjusting and allocating partnership items and "the applicability of any penalty . . . which relates to *an adjustment to a partnership item*" (emphasis added).

Tax statutes are strictly construed, and the phrase "attributable to" mandates direct causal relationships—indirect, attenuated, "but for" relationships are not enough. Similarly, affected items may not be reclassified or treated as partnership items simply because they would not exist but for partnership items.

Because §6226(f) and §6233 are jurisdictional, their terms may not be waived or altered. Consequently, the district court did not have jurisdiction to determine the §6662 substantial valuation misstatement (SVM) penalty because:

- once a partnership is determined to be a sham and disregarded for tax purposes, all further proceedings should be conducted at the partner level, and §6233 should be construed to confer jurisdiction only to make the sham determination and dismiss the suit;
- even if the "hypothetical partnership" treatment

under §6233 applies to a "sham" partnership, §6226(f) confers jurisdiction only to determine the applicability of a penalty based on determinations of adjustments to what would be partnership items, not affected items, specifically outside basis; and

- the district court made no valuation or basis determinations; therefore, on these facts, it had no jurisdiction to determine the applicability of penalties where no adjustments they might relate to were made, nor did it have jurisdiction to determine losses not claimed by the partnership at all.

If the district court had jurisdiction of the SVM penalty, then it correctly held that §6662(b)(3)'s restriction of that penalty to apply to "the portion of any underpayment attributable to . . . [a]ny [SVM]" precludes its application where deductions are disallowed on grounds other than valuation.

If the inapplicability of the SVM penalty is reversed, then the Court should make clear that:

- its analysis of the precedential or persuasive impact of the "Blue Book" formula does not implicate the similar formula formally prescribed by the Secretary in Treas.Reg. §301.6621-2T, A-5, to determine the portion of an underpayment attributable to a tax motivated transaction (TMT) for purposes of imposing "penalty" interest under former §6621(c); and
- its ruling does not apply where there is no

> ultimate, affirmative finding of an overvaluation in the relevant partnership-level proceeding.

ARGUMENT

1. Jurisdiction

The Court ordered the parties to address:

> Whether the district court had jurisdiction in this case under 26 U.S.C. §6226 to consider the substantial valuation misstatement penalty.

Woods, 133 S. Ct. at 1632.

The answer depends on the jurisdictional character and scope of §6226 and the tax year involved.

a. Test for Jurisdictional Character of Tax Statutes

There is no specific test for the jurisdictional character of tax statutes. This Court's guidance is needed to clarify that the *Arbaugh*/*Henderson* test applies to §6226 provisions.

Jurisdictional statutes cannot be waived or altered. The Fifth and Federal Circuits split on whether §6226 provisions are jurisdictional. The Fifth Circuit holds §6226(b) and (f) are jurisdictional and cannot be altered.[7] The Federal Circuit treats §6226(d)(1)(B) and (f) as nonjurisdictional by holding that partnership-level courts may waive §6226(d)(1)(B) and expand

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[7] *A.I.M. Controls, LLC v. Commissioner*, 672 F.3d 390, 395 (5th Cir. 2012).

§6226(f) to encompass nonpartnership-items.[8] Therefore, the threshold issue in answering the Court's question is identifying the test for jurisdictional character of tax statutes.

Arbaugh established congressional intent as the "readily administrable bright line" test in Article III courts.[9] *Henderson* articulated factors and extended that test to "review by an Article I tribunal as part of a unique administrative scheme."[10]

The Fifth Circuit applies *Henderson* to determine the jurisdictional character of TEFRA's §6226 provisions.[11] The Federal Circuit rejects application of *Henderson* to §6226, asserting *Henderson* concerned a veterans statute and not the partnership tax issues in §6226.[12]

This Court broadly applies the *Arbaugh*/ *Henderson* test.[13] Every circuit, including the Federal

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[8] *Prati*, 603 F.3d at 1307-08 and n.4.

[9] *Arbaugh*, 546 U.S. at 546.

[10] *Henderson*, 131 S. Ct. at 1202-06.

[11] *A.I.M. Controls*, 672 F.3d at 393-95.

[12] *Fournier v. United States*, 2012 U.S.App. LEXIS 24525, *7 (Fed.Cir. 2012).

[13] *Mann v. United States*, 131 S. Ct. 1598, 179 L. Ed. 2d 496 (2011) (criminal); *Stern v. Marshall*, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011) (bankruptcy); *Sebelius v. Auburn Reg'l Med. Ctr.*, 133 S. Ct. 817, 184 L. Ed. 2d 627(2013) (Medicare); and *Gonzalez v. Thaler*, 132 S. Ct. 641, 181 L. Ed. 2d 619 (2012) (Antiterrorism and

Circuit (except as to §6226),[14] broadly applies *Arbaugh*/*Henderson*'s general test to federal statutes, unless a more specific test applies.[15]

b. Under the *Arbaugh*/*Henderson* Test 26 U.S.C. §6226(a)-(g) are Jurisdictional

Statutes have adjudicatory authority if they delineate the classes of cases (subject-matter jurisdiction) and the persons (personal jurisdiction) implicating that authority.[16] Jurisdictional character attaches whether a statute grants or limits a grant of

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Effective Death Penalty Act of 1996).

[14] *Palacios v. United States*, 2012 U.S. App. LEXIS 5014 (Fed. Cir. 2012) (unpublished), *aff'g* 100 Fed. Cl. 656 (2011) (summarily affirming *Henderson*'s broad general scope). F.R.A.P. 32.1.

[15] *Alphas Co. v. William H. Kopke, Jr., Inc.*, 708 F.3d 33 (1st Cir. 2013); *City of New York v. Mickalis Pawn Shop, LLC,* 645 F.3d 114 (2d Cir. 2011); *NLRB v. New Vista Nursing & Rehab*., 2013 U.S. App. LEXIS 9860 (3rd Cir. 2013); *United States v. Wilson*, 699 F.3d 789, 793-97 (4th Cir. 2012); *La. Envtl. Action Network v. City of Baton Rouge*, 677 F.3d 737, 745-49 (5th Cir. 2012); *Brentwood at Hobart v. NLRB*, 675 F.3d 999, 1002-05 (6th Cir. 2012); *In re IFC Credit Corp.*, 663 F.3d 315, 319-20 (7th Cir. 2011); *Mader v. United States*, 654 F.3d 794, 805-08 (8th Cir. 2011); *Payne v. Peninsula Sch. Dist.*, 653 F.3d 863, 867-71 (9th Cir. 2011) (*en banc*); *United States v. McGaughy*, 670 F.3d 1149 (10th Cir. 2012); *Avila-Santoyo v. AG*, 713 F.3d 1357 (11th Cir. 2013) (*en banc*); and *Netcoalition & Secs. Indus. & Fin. Mkts. Ass'n v. SEC*, 715 F.3d 342 (D.C. Cir. 2013).

[16] *Kontrick v. Ryan*, 540 U.S. 443, 455, 124 S. Ct. 906, 157 L. Ed. 2d 867 (2004).

jurisdiction.[17] Congress can attach jurisdictional conditions to rules that courts would prefer to call claim-processing rules.[18]

Under *Arbaugh*, an enactment is jurisdictional if Congress "clearly states that a threshold limitation on a statute's scope shall count as jurisdictional."[19]

Section 6226 is titled "Judicial Review of Final Partnership Administrative Adjustments" (FPAAs). No other statute controls judicial review of FPAAs.

Subsection (f) is titled "Scope of Judicial Review" and for all tax years states that:

> [a] court with which a petition is filed [under] this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the [FPAA] relates and the proper allocation of such items among the partners . . . .

Subsections (c), (d), and (e), as well as §6231(a)(3)'s definition of "partnership item," all clearly impose a threshold limitation on the scope of partnership-level jurisdiction. The jurisdictional label was expressly attached to §6226(c), (d), (e), (f), and §6231(a)(3) (for purposes of §6226(f)).

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[17] *Gonzalez*, 132 S.Ct. at 648-49.

[18] *Henderson*, 131 S.Ct. at 1203.

[19] *Gonzalez*, 132 S.Ct. at 648, quoting *Arbaugh*, 546 U.S. at 515.

Henderson's factors determine a statute's jurisdictional character when the word "jurisdiction" is missing. They include whether:

- the provision's text clearly evidences intent to carry jurisdictional consequences, *i.e.*, it speaks in jurisdictional terms or refers to a court's jurisdiction;
- its placement within the statutory scheme evidences jurisdictional intent:
- another provision prescribes that jurisdiction;
- those subject to the scheme are due equitable deference; and
- Congress has left undisturbed a long line of this Court's decisions treating that or a similar provision as jurisdictional.[20]

Subsections (a), (b)(1), (b)(5), and (d)(2) restrict the classes of persons who may file a petition and dictate filing periods.

Subsections (b)(6),[21] (c), and (d) establish or restrict the classes of persons (i) who may be parties, and (ii) who (parties or non-parties) may participate.

Subsections (b)(2)-(5)[22] determine which of duplicate suits are dismissed.

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[20] *Henderson*, 131 S.Ct. at 1203-06 and cases cited therein.

[21] Designated (b)(5) for pre-1997 tax years.

[22] Subsections (b)(2)-(4) and (b)(6) for pre-1997 tax years.

Subsection (e) prescribes additional "jurisdictional requirement[s]" to sue in federal district court or the Court of Federal Claims (CFC).

Subsection (g) restricts the classes of persons who may appeal.

Only subsection (h) ("Effect of Decision Dismissing Action") goes to the effect of adjudication rather than authority to adjudicate.

Subsections (a)-(g) expressly or implicitly speak in jurisdictional terms and place threshold limits on a partnership-level court's adjudicatory authority.

Henderson's factors reinforce that subsections (c), (d), (e), and (f) are jurisdictional and clarify congressional intent that the jurisdictional label attach to subsections (a), (b), and (g).

Those factors also extend jurisdictional impact to §6231(a)(3)'s definition of "partnership item" to the extent it limits §6226's jurisdictional provisions, including (f); consequently, that definition is strictly construed and cannot be waived or altered. The Tax Court has recently acknowledged the importance of the definition of "partnership items" in determining partnership-level jurisdiction.[23]

In *A.I.M. Controls*, the Fifth Circuit held that, unlike the veterans filing deadline in *Henderson*, the

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[23] *6611, Ltd. v. Commissioner*, T.C. Memo 2013-49, *P45 (Feb. 14, 2013).

§6226(b) filing deadline is jurisdictional.[24] It recognized that, unlike the deference owed to veterans, rigid jurisdictional treatment of §6226 provisions does not clash with TEFRA's scheme because tax law is generally not subject to equitable exceptions.[25]

Finally, while this Court has never addressed §6226, Congress has left undisturbed a long line of decisions strictly construing technical tax statutes and holding they are not subject to equitable considerations.[26] This lack of equity is a fundamental reason why tax laws, especially those involving jurisdiction, must be strictly construed. For example, where a statute uses jurisdictional language to expressly forbid a class of persons to be parties to or to participate in a suit, those persons should not later be bound to that suit.

This Court's guidance is needed to clarify that §§6226(a)-(g) and 6231(a)(3) (for purposes of §6226(f)) are jurisdictional under the *Arbaugh*/*Henderson* test and cannot be waived or altered.

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[24] *A.I.M. Controls*, 672 F.3d at 394-95.

[25] *A.I.M. Controls*, 672 F.3d at 394, citing *United States v. Brockamp*, 519 U.S. 347, 352, 117 S. Ct. 849, 136 L. Ed. 2d 818 (1997).

[26] See *Commissioner v. Gooch Milling & Elevator* Co., 320 U.S. 418, 422, 64 S. Ct. 184; 88 L. Ed. 139 (1943); *Lewyt Corp. v. Commissioner,* 349 U.S. 237, 249, 75 S. Ct. 736, 99 L. Ed. 1029(1955); *Helvering v. NW Steel Rolling Mills, Inc.*, 311 U.S. 46, 49, 61 S. Ct. 109, 85 L. Ed. 29(1940).

c. Judicial Review Under TEFRA

In TEFRA, Congress created three classes of "items"[27] and two levels of proceedings. An item's classification controls whether its tax treatment is determined at the *partnership* or *partner* level.

i. Classification

TEFRA classifies every item as either:

- a **partnership item**, which §6231(a)(3) narrowly defines as:

> any item required to be taken into account for the partnership's taxable year under any provision of subtitle A [§§1-1563] to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle [F, §§6001-7874], such item is more appropriately determined at the partnership level than at the partner level;

- a **nonpartnership item**, which §6231(a)(4) defines as "an item which is (or is treated as) not a partnership item"; or
- an **affected item**, which §6231(a)(5) defines as "any item to the extent such item is affected by a partnership item."

Partnership-*level* issues and partnership-*related* items are not *ipso facto* partnership items. Technical

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[27] An undefined term.

tax statutes are strictly construed.[28] For tax purposes, congressional definitions control, even if courts would otherwise conclude differently.[29] Consequently, only items "required to be taken into account . . . under . . . subtitle A" can qualify, and they only become partnership items if the Secretary properly designates them by regulation.[30] Treas.Reg. §301.6231(a)(3)-1 designates partnership items. Items the partnership takes into account under subtitle A are not partnership items even if they are more appropriately considered at the partner level *unless* they are properly designated.[31]

Treas. Reg. §301.6231(a)(3)-1(a)(4) clarifies that items and issues are partnership items only if the partnership can "conclusively" determine them at the partnership level without partner-specific facts. *Id.* at 191.

Items with partnership-item and nonpartnership-item elements are affected items, not partnership

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[28] *Lewyt Corp.*, 349 U.S. at 249; *NW Steel*, 311 U.S. at 49.

[29] *Sanford's Estate v. Commissioner,* 308 U.S. 39, 48, 60 S. Ct. 51; 84 L. Ed. 20 (1939); *Badaracco v. Commissioner,* 464 U.S. 386, 398, 104 S. Ct. 756; 78 L. Ed. 2d 549 (1984).

[30] Section 6231(a)(3) empowers the Secretary to designate partnership items from among an expressly prescribed universe. Nothing empowers the Secretary to *define* or re-define "partnership item." BUS:8.

[31] *Grigoraci v. Commissioner*, 84 T.C.M. (CCH) 186, 189 (2002).

items.[32]

Congress prescribes when an item's classification can change:

- Ten provisions prescribe when partnership items "become" or "shall be treated as" *non*partnership items;[33]
- §6231(a)(5) prescribes when and to what extent nonpartnership items may be treated as affected items;
- §6231(c)(2) empowers the Secretary to promulgate regulations identifying additional circumstances under which items "shall be treated as nonpartnership items."

Congress prescribes zero circumstances under which *non*partnership items or affected items become or shall be treated as partnership items. And nothing empowers the Secretary to do so by regulation.

ii. Judicial Review, Generally

In TEFRA, Congress enacted a two-tiered system of judicial review–at the partnership level *and* the partner level. Both levels must engage to function

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[32] *Affiliated Eqmt Leasing II v. Commissioner*, 97 T.C. 575, 578 (1991), citing *N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741, 743-745 (1987) and *White v. Commissioner*, 95 T.C. 209, 212 (1990).

[33] §6223(e)(2), (e)(3)(B), §6227(c)(3)(pre-2002)/(d)(3)(post-2002), §6228(b)(1), (b)(2)(A)(ii), §6231(b)(1)(A)-(D), and (c)(2).

properly and effectuate the statutory language.[34]

Subject to numerous exceptions,[35] §6221 requires that "the tax treatment of any partnership item shall be determined at the partnership level."[36] Consequently, partnership items, including any partnership-item elements of affected items, are normally reviewed and determined first. §6226(a), (e). Unless expressly barred, all partners are parties to the partnership-level suit. §6226(c), (d).

After a partnership-level suit concludes, the Secretary applies any partnership-item adjustments or re-allocations to separately assess the resulting tax liability, if any, against each bound partner. §6225(a). That assessment is a "computational adjustment," which §6231(a)(6) defines as:

> the change in the tax liability of a partner which properly reflects the treatment under this subchapter [63C] of a partnership item.

Unless excepted, §6212(a) requires the Secretary to issue a deficiency notice before assessing against a

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[34] *Monti v. United States*, 223 F.3d 76, 82 (2d Cir. 2000); *Prochorenko v. United States*, 243 F.3d 1359, 1363 (Fed. Cir. 2001); *Field v. United States*, 328 F.3d 58 (2d Cir. 2003).

[35] *E.g.*, settlement or bankruptcy. §§6224(c)(1), 6231(c)(2) and Treas.Reg. §301.6231(c)-7.

[36] While not jurisdictional under *Henderson*'s factors, §6221 is mandatory. See generally, *Union Pacific R. Co. v. Locomotive Engineers and Trainmen Gen. Comm. of Adjustment, Central Region*, 130 S. Ct. 584, 596, 175 L. Ed. 2d 428 (2009).

taxpayer. Section 6230(a)(1) of TEFRA excepts the Secretary from issuing deficiency notices prior to most computational adjustments. But, §6230(a)(2)(A) reimposes that duty for "any deficiency attributable to . . . affected items which require partner level determinations (other than penalties, additions to tax, and additional amounts that relate to partnership items) . . ." (parenthetical not applicable for pre-1997 tax years).

Under TEFRA, penalties are quintessential affected items and virtually always require further partner-level determinations. BUS.11. Nevertheless, the 1997 amendment excepts post-1996 penalties from deficiency notice requirements if the assessment "reflects the treatment under this subchapter [63C] of a *partnership item*" (emphasis added). §§6230(a)(2)(A)(i), 6231(a)(6).

Assessing deficiencies that reflect the treatment of *affected items* that require partner-level fact findings can never be a §6231(a)(6) computational adjustment.

A partner's outside basis is an affected item that always requires partner-level determinations. BUS.32,34. It is irrational that Congress intended penalties to be imposed without deficiency notices based on affected-item changes that themselves require deficiency notices.

If a deficiency notice issues, the partner can sue in the Tax Court pre-assessment and pre-payment to raise her partner-level defenses. §6213(a).

If no deficiency notice issues and she can pay, she can seek a refund. If, as the United States contends,

§6230(c) controls, then *if* the Secretary sends a vague and undefined "notice of computational adjustment" (which the Secretary is not required to send), then the partner must pay in full and file her claim within six months of that notice, regardless of whether any liability has actually been assessed.

If the partner cannot pay in full within six months, then, under the United States' analysis, she can never claim a refund regardless of the magnitude of the overassessment, based on a defense or error in the computational adjustment. For example, where the Secretary erroneously assesses $500,000 against an elderly partner on a fixed income with total assets of $100,000 and after six months the Secretary seizes those assets, then the §6230(c) requirement to pay and file for refund within six months is a clear violation of her rights to substantive and procedural due process.

In theory, partners who cannot pay erroneous assessments can seek relief in administrative CDP hearings after liens are issued or levies threatened and appeal any adverse determination to the Tax Court. §§6320(c), 6330(d)(1). But that potential relief is problematic. The extent to which CDP hearings can review computational adjustments is unclear. The United States' analysis assumes that §6230(a)(1) denies partners all access to CDP hearings. If CDP hearings are available, they still do not cure the due process problem because they become available only when a lien issues or a levy is threatened, which is virtually always more than six months after assessment, while interest continues to accrue and a 1% per month failure to pay penalty is normally

imposed. If §6230(c) controls refund claims, then partners can only obtain their right, if any, to a CDP hearing by waiving and forfeiting their right to ever file a refund claim.

Further, without deficiency notices, partners who are forced to and can seek CDP relief actually increase the total administrative burden because they must pursue administrative hearings *before* appealing to the Tax Court, instead of going straight to the Tax Court via deficiency notices.

TEFRA's prescriptions for partner-level suits are consistent for all fora. Partner-level courts determine only nonpartnership items and affected items. Section 6221 (and §7422(h), if applicable) forbids them to determine *de novo* or redetermine partnership items.[37] To determine affected items, a partner-level court determines their nonpartnership-item elements and *applies* any partnership-item elements previously determined in a partnership-level suit to which *res judicata* binds that partner.[38] If a party bears the burden on a partnership-item element and failed to obtain that determination at the partnership-level, then that party loses that affected-item claim or defense.

Generally, when a tax statute limits a thing to be done in a particular mode, it includes the negative of

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[37] See also §6230(c)(4).

[38] *Dial USA, Inc. v. Commissioner*, 95 T.C. 1, 6 (1990).

any other mode.[39] And when Congress includes particular language in one section of TEFRA but omits it in another, it is generally presumed that Congress acts intentionally and purposely in that disparate inclusion or exclusion.[40]

"Attributable to" is not defined. For tax purposes, it means "due to, caused by, or generated by."[41] Further, it requires a direct causal relationship, even being "substantially related" is not enough.[42]

TEFRA specifies what must be "attributable to" what for each given context:

- **refund** attributable to . . . ;[43]

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[39] *Botany Worsted Mills v. United States*, 278 U.S. 282, 289 (1929).

[40] *Curr-Spec Partners., L.P. v. Commissioner*, 579 F.3d 391, 398 and n.33 (5th Cir. 2009); citing *A.D. Global Fund, LLC v. United States*, 481 F.3d 1351, 1354 (Fed.Cir.2007).

[41] *Keener v. United States*, 551 F.3d 1358 (Fed. Cir. 2009)

[42] *Stanford v. Commissioner*, 152 F.3d 450, 459 (5th Cir. 1998) ("attributable to" is strictly construed for §952(c)(1)(C)(i)); *Weiner*, 389 F.3d at 160-163 ("attributable to" narrowly construed for §6621(c) penalty interest); *Heasley v. Commissioner*, 902 F.2d 380, 383 (5th Cir. 1990) (underpayment must be solely "attributable to" §6659(a) valuation overstatement); *Alexander v. United States*, 44 F.3d 328, 331 (5th Cir. 1995) ("attributable to" in §7422(h) requires direct, not indirect, causal relationship). See also *Rigas v. United States*, 2012 U.S. App. LEXIS 17636, *20-*24 (5th Cir. Aug. 21, 2012) (unpublished) (§7422(h) cannot bar jurisdiction where refund not directly attributable to partnership item).

[43] §7422(h) and §6230(d) (shorthanded title only).

- **deficiency** attributable to . . . ;[44]
- **tax** attributable to . . . ;[45]
- **liability** attributable to . . . ;[46]
- **overpayment** attributable to . . . ;[47]
- . . . attributable to **partnership items**;[48]
- . . . attributable to **partnership items (and/or affected items)**;[49]
- . . . attributable to **affected items**;[50]
- . . . attributable to **nonpartnership items**;[51]

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[44] §6222(c)(2), §6225(a), §6230(a)(2)(A), (a)(2)(B), §6234(d)(2), (e)(3), (g)(1).

[45] §6226(d)(1)(B), §6228(a)(3)(C), §6229(a), (b)(3), (c)(1)(A), (c)(3), (e), (f)(1), (f)(2), §6230(d)(1), §6234(g)(2), (g)(4)(C).

[46] §6230(a)(3)(A), and (c)(5)(A).

[47] §6228(b)(1)(A), §6230(c)(1)(B), (d)(1)-(6).

[48] §6225(a), 6226(d)(1)(B), §6228(a)(3)(C), §6229(b)(3), §6230(d) (title), (d)(6), §6234(g)(4)(C), post-1997 §6230(d)(6), and §7422(h).

[49] §6229(a), (c)(1)(A), (c)(3), (e), §6230(d)(1)-(5), §6234(g)(2), pre-1997 §6230(d)(6)

[50] §6230(a)(2)(A)(i), §6234(d)(2), (g)(1).

[51] §6228(b)(1)(A).

• . . . attributable to [other][52].

Blurring the distinction between partnership items and affected items, introducing ambiguity into the requirement of a direct causal relationship between an issue and the item it is attributable to, and non-statutory denial of access to judicial review at either level are all contrary to and frustrate the carefully crafted system for separate treatment enacted in the statutory language.

Congress intended and enacted judicial review at both levels.[53] Partnership-level suits streamline the determination of common partnership items while numerous provisions protect the partners' due process rights. Partner-level suits protect the partners' rights and interests in their partner-level defenses while ensuring that partnership-item determinations are properly applied but not revisited.

iii. Scope of §6226
Before the 1997 Amendments

TEFRA is generally effective for all partnership tax years beginning after September 3, 1982. Many §6226 provisions were amended in 1997; therefore, the scope of §6226's jurisdictional grants and limits is determined by the tax year involved.

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[52] §6222(c)(2) (computational adjustment), §6229(f)(1) (converted/affected items), (f)(2) (settled items), §6230(a)(2)(B) (each partnership), (a)(2)(A), (c)(1)(B) (settlement, FPAA, decision), (c)(5)(A), and §6234(e)(3) (essentially nonpartnership items).

[53] See footnote 34.

For pre-1997 tax years, §6226(f) states:

> (f) SCOPE OF JUDICIAL REVIEW.–A court with which a petition is filed in accordance with this section *shall have jurisdiction to determine all partnership items* of the partnership for the partnership taxable year to which the [FPAA] relates and the proper allocation of such items among the partners.

(Emphasis added.)

Section 6226(f) grants partnership-level jurisdiction only to adjust and allocate §6231(a)(3) "partnership items." Nothing grants partnership-level jurisdiction of any nonpartnership item or affected item.[54] Because §6226(f) is jurisdictional, its limits cannot be waived and its scope cannot be expanded. Correspondingly, because §6231(a)(3)'s narrow definition of "partnership item" limits §6226(f) jurisdiction, it is jurisdictional in that context and its requirements cannot be waived or altered.[55]

iv. Scope of Amended §6226

Section 6226(f)'s 1997 amendment granted new partnership-level jurisdiction of "the *applicability of* any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item"

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[54] *Grigoraci*, 84 T.C.M. at 189-91.

[55] As discussed in section 1.b above, every provision of §6226, except (h), is also jurisdictional.

(emphasis added).[56] This means that for post-1996 tax years, partnership-level courts can determine whether:

- any penalty, etc., that "relates to an *adjustment to a partnership item*" may apply; and
- as a matter of law, a penalty *cannot* apply if *grounded on that court's partnership-item determinations*.

Nothing in the 1997 amendments alters the definition of "partnership item" or converts affected items into partnership items. Nor does amended §6226(f) grant jurisdiction generally of nonpartnership items or affected items. In particular, they did not grant partnership-level jurisdiction of nonpartnership-item fact determinations, *i.e.*, to determine whether a penalty, etc., applies to specific partners and, if so, their liability. BUS:34-35. That aggressive interpretation would frustrate TEFRA's bifurcated scheme for review and render partnership-level suits unmanageable, and render inoperative or superfluous, void or insignificant the express reservation of each partner's right to assert his individual defenses in later partner-level proceedings.[57]

For post-1996 tax years, a partnership-level court's

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[56] Sections 6221 and 6230(a)(2)(A)(i) were similarly amended.

[57] *Corley v. United States*, 556 U.S. 303, 314, 129 S. Ct. 1558; 173 L. Ed. 2d 443 (2009) ("A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant . . . ."), quoting *Hibbs v. Winn*, 542 U.S. 88, 101, 124 S. Ct. 2276, 159 L. Ed. 2d 172 (2004) (footnote and internal quotation marks omitted).

penalty jurisdiction is limited to cases where their application can be determined *as a matter of law* without regard to any partner-level facts and only if related to an adjustment to a partnership item, not an adjustment to an affected item that cannot occur until after the partnership-level suit concludes.

The issue of whether any partner-level fact findings are required to assess a resulting liability, if any, against a specific partner remains a nonpartnership item. Thus, after 1997, partnership-level courts still lack jurisdiction to determine whether §6230(a)(2)(A)(i) requires the Secretary to issue a deficiency notice. Partnership-level courts can now determine *whether* certain penalties, etc., may apply but they cannot determine the Secretary's later *method* of assessment.[58] For example, if IRS records reflect that a partner amended his return but the Secretary lost that information, then §6230(a)(2)(A)(i) requires the Secretary to issue a deficiency notice before assessing to determine, *inter alia*, whether the amended return removed some or all of the later-disallowed losses.

The United States argues that §6226(f)'s amended language should be judicially expanded to abrogate the Secretary's §6230(a)(2)(A)(i) duty to issue deficiency notices. BUS.10-11, 28-29, 37-38. It erroneously rationalizes that this would reduce the Secretary's

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[58] Partnership-level courts are not required to identify the partners bound to the outcome of the suit. Identity of the partners is either a partnership item or a nonpartnership item depending on the facts. *Grigoraci*, 84 T.C.M. at 189-91.

administrative burden and lighten the Tax Court's docket. But if a partner disputes the *application* of partnership-item adjustments in later determining his liability, then forcing her to pursue the questionable alternative remedies (discussed on pp. 18-20) ultimately results in a greater administrative burden than simply issuing deficiency notices, and severely diminishes the partner's right to redress of erroneous computational adjustments.

v. Section 6226(f) Partnership-Level Jurisdiction of Penalties

Section 6226(f) grants jurisdiction of partnership items, including partnership-item elements of affected items for all TEFRA tax years. For tax year 1999, amended-§6226(f) granted the district court jurisdiction of "the *applicability of* any penalty" but *not* of any nonpartnership-item, partner-level fact findings required to impose any penalty directly on a partner. No penalty based on a deficiency due to a partner's overstatement of her outside basis can be determined until after her outside basis is determined and a resulting deficiency exists.[59]

Amended §6226(f) granted the district court jurisdiction only to determine:

- whether the entire COBRA transactions lacked economic substance such that the *partnerships* should be disregarded as shams and, potentially, any deductions claimed on the

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[59] *Petaluma FX Partners, LLC v. Commissioner*, 591 F.3d 649, 654-56 (D.C. Cir. 2010).

partnership returns disallowed;[60] and

- that the §6662 SVM penalty *is not applicable* to the partners as a matter of law *based on those disallowances*, because precedent holds that any resulting underpayment is attributable to claiming an improper deduction and not to any valuation overstatement purportedly included in that now totally disallowed deduction;[61] or
- that it has no jurisdiction of the asserted penalties.

Res judicata binds all parties to those determinations, if upheld. After this partnership-level suit concludes, the IRS is free to impose §6662 SVM penalties on any partner against whom it has nonpartnership-item grounds or against whom it otherwise obtained partnership-item grounds, *e.g.,* by individual settlement. §6224(c)(1). Those partners can raise their partner-level defenses in a partner-level proceeding where the partnership-item determinations are applied but not revisited. §§6230(c)(4), 7422(h).

Generally, the district court had jurisdiction to hold that its partnership-item determinations *could not* apply/impose the §6662 SVM penalty on *any* bound partner as a matter of law. But it had no jurisdiction to apply/impose the §6662 SVM penalty directly on any

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[60] *Woods v. United States*, 794 F.Supp.2d 710, 713 (W.D.Tex. 2010).

[61] *Woods v. United States*, 794 F.Supp.2d 714, 717 (W.D.Tex. 2011), citing *Heasley*, 902 F.2d at 383.

partner because that requires partner-level fact determinations it cannot make. The most it could do to assist the Secretary in imposing the §6662 SVM penalty, or any other, was to:

- make partnership-item determinations, and
- determine whether and to what extent those partnership-item determinations could later make a specific penalty applicable.

6611, Ltd. provides a recent example from the Tax Court.

The Secretary can later rely on those determinations to impose any such penalty at the partner level. But on the facts of *Woods* here, no such determinations were available or made. See the discussion on pp. 35-38.

The United States overreaches in arguing that the §6662 SVM penalty proposed here "relates to an adjustment to a partnership item." BUS.22, 31-32. Tax statutes are strictly and narrowly construed. Respondent is correct that on these facts the "adjustment" that purportedly triggers the §6662 SVM penalty is the adjustment to each partner's outside basis, which may be a *nonpartnership* item or an *affected* item, but is never a partnership item. Further, partnership-level courts can hardly have jurisdiction to impose a penalty when they have no jurisdiction to make the adjustment that purportedly triggers that penalty.

The United States invites this Court to circumvent the statutory definition of "partnership item" and

adopt its position (discussed above as to "attributable to") that affected items are treated as partnership items because they would not exist but for partnership items. That invitation should be declined, as it was by other courts that declined to create a judicial "but for" test that would undermine Congressional intent that partnership items and affected items be treated differently.[62]

vi. The Effective Dates of the 1997 Amendments

This Court's opinion will impact the jurisdictional analyses of all partnership-related cases of all tax years.

The partnership-level suits relevant to the *amici*'s suits were pending for years before the 1997 amendments, some of which Congress made retroactive to TEFRA's 1982 enactment[63] and others it made prospective only.[64] Every §6226 amendment was prospective, effective for tax years ending after August

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[62] See *United States v. Steinbrenner*, 2013 U.S.Dist. LEXIS 80290, *11-*16 (M.D.Fla. June 7, 2013) and cases cited therein.

[63] See §6230(a), (a)(1), and (c). Taxpayer Relief Act of 1997 (TRA 1997), P.L. 105-34, §§1237(a), (b), and (c)(1).

[64] §6226(d)(1)(B) and (f). TRA 1997, P.L. 105-34, §1238(b)(1)(A)-(B) and §1239(b); see also §6221, §6225(b), §6230(a)(2)(A)(i), (3)(A), (a)(3)(B), (c)(1), (c)(2)(A), (c)(4), (c)(5)(A), (c)(5)(D), (d)(6), §6231(a)(1)(B)(i), (g), and §6234. TRA 1997, P.L. 105-34, §1232(a), §1234(a), §1238(a), (b)(2), (b)(3)(A), (b)(3)(B), (b)(3)(C), (b)(3)(D), (b)(4), (b)(5), (b)(6), and §1239(a), (c)(1).

5, 1997.[65]

Some courts hold that *amici* and similarly situated partners waived or forfeited their limitations and penalty interest defenses because they did raise those issues in the partnership-level suits, *i.e.*, that the pre-1997 §6226(d)(1)(B) and (f) threshold limits on partnership-level personal and subject matter jurisdiction are nonjurisdictional and may be waived or altered. Some also hold that the 1997 amendments merely codified the Tax Court's prior practice, thus treating the effective dates of the 1997 amendments as nonjurisdictional and rendering pre-1997 §6226(d)(1)(B) meaningless.[66]

Effective dates are neither meaningless nor optional.[67] The Tax Court holds it cannot ignore the TRA 1997 effective dates.[68] Retroactivity to circumvent express effective date is impermissible.[69]

Under *Henderson*'s factors, the 1997 §6226

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[65] Except the amendment to §6226(b), which was made effective for petitions filed after August 5, 1997. TRA 1997, P.L. 105-34, §1238(b)(1)(A)-(B).

[66] *Prati*, 603 F.3d at 1307-08 and n.4.

[67] *Lockheed Corp. v. Spink*, 517 U.S. 882, 896-97, 116 S. Ct. 1783; 135 L. Ed. 2d 153 (1996).

[68] *Ochsner v. Commissioner*, T.C.Memo 2010-122, 2010 WL 2220305, *5; *Williams v. Commissioner*, T.C.Memo 2009-158, 2009 WL 1884150, *2.

[69] *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265, 114 S. Ct. 1483; 128 L. Ed. 2d 229 (1994).

amendments *and* their effective dates are jurisdictional and cannot be waived or altered. While this Court need not resolve the specific limits of pre-1997 partnership-level jurisdiction here, guidance as to whether the *test* for a statute's jurisdictional character also applies to that statute's effective date would reduce both litigation below and future petitions to this Court.

To hold, or even imply by silence, that the 1997 §6226 amendments apply for pre-1997 tax years would circumvent clear congressional intent, invite more confusion, and leave taxpayers like *amici* in a continuing quagmire of conflicting rulings on the jurisdictional character of §6226 provisions.

Amici urge this Court, at a minimum and as appropriate, to clarify that the §6226 provisions, except (h), are jurisdictional and that no inferences should be drawn *sub silentio* as to whether or how its jurisdictional analyses and holdings here apply for pre-1997 tax years.

d. Section 6226(f) Jurisdictional Consequences of Sham Determination

There are critical jurisdictional consequences to the district court's "sham" ruling that:

> [T]he [relevant] "transaction" . . . is the Plaintiff's use of two partnerships with a six-week life span to conduct . . . trading for the sole purpose of generating a paper loss. . . . The "Tinker to Evers to Chance" routine . . . (the transfer of assets from individuals to LLCs to partnerships to Subchapter S

> corporations) was not "compelled or encouraged by business or regulatory realities," nor was it "imbued with tax independent considerations." . . . It was totally lacking in economic substance and was for the sole purpose of creating a tax benefit.

Woods, 794 F.Supp.2d at 713 (citations omitted).

The parties agree the district court meant the partnerships themselves were shams.[70]

Neither party addresses that holding's jurisdictional consequences. Presumably, but for §6233, the district court had no jurisdiction. The United States argues that §6233 resolves this threshold problem because filing a partnership return subjects that return and persons who would be partners under §6226(c), (d), to TEFRA procedures, even if there is no

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[70] This is consistent with the FPAA determinations that:

> 2. . . . .Accordingly, the partnership and the transactions described above shall be disregarded in full and any purported losses resulting from these transactions are not allowable as deductions for federal income tax purposes.
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> • • • •
>
> 3. . . . .
>
> a. SA Tesoro Investments Partners is disregarded and that all transactions engaged in by the purported partnership are treated as engaged in directly by its purported partners.

See Plaintiffs' Trial Exhibit 178 (*Woods*, WDTX 05-216) (SATIP FPAA). See also Plaintiffs' Trial Exhibit 177 (TD Partners FPAA).

partnership.

But how to implement §6233 is unclear. *Amici* would argue that when a court holds a partnership is a sham to be disregarded for tax purposes, the rational application of §6233 is for the court to then enter *that* decision as the totality of its holdings. If the partnership is to be disregarded for tax purposes, the next step should be for the Secretary to pursue partner level deficiency procedures. If there is no recognition of the partnership, there are no "partnership items" to be determined, and all transactions should be treated as conducted directly by the partners. This resolves all of the otherwise grossly complex issues plaguing this case.

The Tax Court recently took a different approach to applying §6233 to a disregarded partnership. In *6611, Ltd.*, it explained its treatment of §6233 thusly:

> The Code tells us that TEFRA procedures will still apply in these cases as long as the purported partnership filed a partnership return . . . . This means we have to determine in these cases any items that would have been "partnership items," . . . had [the partnerships] been valid partnerships for tax purposes. . . . This is the "hypothetical entity" approach. . . .

6611, Ltd, at *P62.

However, the Tax Court clarified that the substantive partnership tax law of subchapter K *does not apply* (*i.e.*, it would apply non-partnership substantive law at the "hypothetical" partnership level). *Id.* at *P61. *Amici* can find no appellate opinions

on the issue and would argue that theirs is the better approach (applying non-partnership substantive law at the partner level).

But even under the Tax Court approach to §6233, which appears to be the approach adopted by the district court here, nothing in §6226(f) gave the district court partnership-level jurisdiction to make determinations *beyond* the bounds of the partnership returns before it. By holding the transactions to be shams, the district court did not somehow expand its jurisdiction to disallow deductions (capital losses and ordinary losses) presumed to have been ultimately claimed by the putative partners **but not claimed by the partnership at all**. Based on the district court's fact findings, those deductions were simply presumed to have been claimed by the S corporations after the partnership was terminated.

Specifically, the district court found:

> As the year 1999 was coming to a close, both partnerships transferred all their remaining assets to the two Subchapter S corporations, effectively resulting in the liquidation of the partnerships. . . . Tesoro Drive Investors, Inc. sold the Canadian Dollars, which Woods and McCombs claimed resulted in an ordinary loss for tax purposes of $13,353,162.00. SA Tesoro Investors, Inc. sold the remaining shares of Sun Microsystems stock, which, according to Woods and McCombs, resulted in a short-term capital loss for tax purposes in the amount of $32,297,786. . . . .

Thus, based on the district court's own findings, the purported losses were incurred and claimed by the S corporations, **not the partnerships**. They were not deductions ever claimed on the partnership returns, and under no possible §6226(f)/§6233 analysis were they "partnership items," even of any "hypothetical partnership."

The district court decision did not specifically disallow the deductions by Woods and McCombs, but only provided:

> It is therefore ORDERED that the Defendant's motion for judgment as a matter of law with respect to the disallowance of the ordinary and capital losses claimed on the partnership returns in this case be, and it is hereby, GRANTED.

Woods, 794 F.Supp.2d at 714 (emphasis in original).

The FPAAs disallowed **no** ordinary or capital losses. In fact, the FPAAs favorably determined for SA Tesoro Investment Partners (SATIP) a reduction in ordinary income of $50,000 and a reduction in interest income of $958, and for Tesoro Drive Partners (TDP) a reduction in ordinary income of $650,000 and a reduction in short term capital gains of $5,037.[71] There simply were NO "ordinary and capital losses claimed on the partnership returns," to be treated as partnership items.

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[71] See Plaintiffs' Trial Exhibit 178 (*Woods*, WDTX 05-216) (SATIP FPAA). See also Plaintiffs' Trial Exhibit 177 (TD Partners FPAA)

The district court opinion rendered no valuation decision or specific determinations as to basis. Any such determinations in the FPAAs were extinguished and deemed conceded when the United States failed to pursue them by defending any such FPAA adjustments.[72]

The district court simply had no jurisdiction under §6226(f) to determine whether deductions claimed by two S corporations and their shareholders were proper, and it did not do so.

It also had no jurisdiction to conclude there were any penalties (negligence, substantial understatement, or overvaluation) attributable to those nonexistent partnership-item adjustments.

Under *amici*'s approach to §6233, the district court had no jurisdiction under §6226(f) to determine the applicability of any SVM penalty if there was no partnership recognized for tax purposes. Nor under the "hypothetical partnership" approach could it determine a SVM penalty applied where no basis or valuation determinations were made and no actual partnership deductions disallowed.

The holding that the entire COBRA investment scheme lacked economic substance would nevertheless be binding on the parties and would be *res judicata* in any later proceedings at the individual taxpayer (purported partner) level. If this Court adopts the "hypothetical partnership" approach to §6233, then any

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[72] *Rovakat, LLC v. Commissioner*, T.C.Memo 2011-225 *P41 n.22 (conceding on brief by failing to defend FPAA adjustments).

"partnership item" determinations regarding the returns of the "hypothetical partnerships" would similarly be *res judicata* as to these parties.

However, it is nonsensical to hold that as to penalties the district court had §6226(f) jurisdiction based on (i) its findings that the partnerships were to be disregarded as shams, (ii) the FPAAs' reduction of income and gains reported by the partnerships, and (iii) the Court's sole determination to disallow a category of deductions never claimed by the partnership.

Amici urge the Court to rule, based on the district court's fact findings, that the district court lacked jurisdiction under §6226(f) to determine the applicability of any SVM penalty.

2. The Blue Book Formula Implements §6662's Statutory Text and Complements Treas.Reg. §301.6621-2T, A-5

Section 6662(b) provides:

> (b) PORTION OF UNDERPAYMENT TO WHICH SECTION APPLIES.–This section shall apply to *the portion* of any underpayment which is attributable to 1 or more of the following:
>
> (1) Negligence or disregard of rules or regulations.
>
> (2) Any substantial understatement of income tax.
>
> (3) Any substantial valuation

misstatement under chapter 1.

• • • •

(Emphasis added).

The statute does not provide, and the Secretary has never promulgated, any formula to calculate the portion of a taxpayer's underpayment subject to the §6662 SVM penalties. Therefore, to determine that portion, in 1988 the Fifth Circuit in *Todd* turned to the Blue Book formula,[73] under which the amount subject to the substantial valuation penalty is the portion left "*after* taking into account any other proper adjustments to tax liability." This is consistent with the Fifth Circuit's interpretation of §6662(b)'s plain language: §6662(b)(1)-(3) penalties are imposed in the alternative, not cumulatively.[74]

The Fifth Circuit recognizes:

> [P]enalties under §6662 must be applied alternatively, not cumulatively, only one of the penalties assessed may be sustained–***they cannot be stacked***. See *Southgate*, 659 F.3d at 492 n.81; *Bemont*, 679 F.3d at 346.

Nev. Partners Fund, L.L.C. v. United States, 2013 U.S. App. LEXIS 12877, *50-*52 (5th Cir. June 24, 2013)

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[73] *Todd v. Commissioner*, 862 F.2d 540, 542-45 (5th Cir. 1988), holding that the Blue Book "formula . . . represents Congress' intent for determining whether to impose the §6659 [later replaced by §6662] addition to tax in any given case."

[74] *Southgate Master Fund, L.L.C. v. United States*, 659 F.3d 466 (5th Cir. 2011).

(emphasis added).

However, the United States would apply the §6662 SVM penalty to 100% of the underpayment where the deductions are disallowed for lack of economic substance. This disregards the fact that if the disallowance were purely based on overvaluation (or overstated basis if the Court finds that is encompassed by the penalty), it would allow a deduction for the correct value or basis, even if it was only a fraction of the total deduction claimed. At a minimum, *that* portion of the disallowance is not based on an actual overvaluation of basis at all. An accurate determination of the applicable "portion" is essential under the statute and cannot be made in this partnership-level suit.

The government has had 25 years (at least since *Todd*) to convince the Secretary to promulgate by regulation a formula it deems consistent with the statute. It has not.

However, in 1984, the Secretary did promulgate a formula in Treas.Reg. §301-6621-2T, A-5, substantively similar to the Blue Book formula, to calculate the portion of a taxpayer's underpayment subject to penalty interest.

"Penalty" interest under former §6621(c) allows the Secretary to impose interest at 120% of the normal rate on any "substantial underpayment" "attributable to" one of the TMTs listed in §6621(c)(3)(A) or Treas.Reg. §301.6621-2T. It and other penalties were quickly repealed in 1989 because Congress found they were "determined too routinely and automatically by the

IRS"[75] and were a "morass of inconsistency and irrationality" that discouraged rather than encouraged compliance and under which a "hapless taxpayer [could] find himself, or herself, confronting the [I.R.C.] over a tax deficiency, where the penalties and interest have been piled on to the extent that they are twice [200% of] the amount of tax in dispute."[76] Despite its repeal in 1989, that "draconian" interest provision continues to dog taxpayers for returns filed in the 1980s.[77]

All *amici* have penalty interest claims.

The Fifth Circuit uses *Todd*'s Blue Book analysis as a "conceptual lens through which to view the statutory phrase 'attributable to' [and Treas.Reg. §301.6621-2T, A-5] in the context of §6621(c)" and hold that under that regulatory formula, if an underpayment is attributable to two grounds, one TMT and one non-TMT, then the portion attributable to the non-TMT is subtracted from the whole *first* and the portion left is subject to penalty interest. *Weiner*, 380 F.3d at 159-163.

In contrast, without finding the regulation invalid

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[75] H. Rep. No. 101-247, 101st Cong. 1041, 1388, 1393, 1394 (1989).

[76] Statement by Senator Pryor introducing S.1784 at 135 Cong. Rec. S13893-7 (0ct. 24, 1989),

[77] *Weiner*, 389 F.3d at 159.

or addressing *Chevron* deference,[78] the Federal Circuit authorizes the Secretary to simply disregard Treas.Reg. §301.6621-2T, A-5, because applying its formula would "invalidate the [TMT] determination."[79]

Two panel members of the Fifth Circuit recently joined Judge Prado's concurrence to question the Blue Book formula.[80] The United States is now relying on that concurrence in trying to convince the Fifth Circuit that the IRS should be allowed to disregard Treas.Reg. §301.6621-2T, A-5 there as it does in the Federal Circuit.[81] *Amici* counter that if the IRS does not like its own regulation, it should not have promulgated it.

While the Court's analysis of the Blue Book's formula will not control *amici*'s penalty interest claims, it will be persuasive on the lower court's interpretation of Treas.Reg. §301.6621-2T, A-5's similar formula.

The overbroad interpretation of penalty statutes requested by the United States may seem justified in a specific case, but it becomes egregious where taxpayers like *amici* were limited partners and the Secretary relies entirely on partnership-level actions

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78 *Chevron U.S.A. Inc. v. N.R.D.C., Inc.*, 467 U. S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984).

79 *Prati*, 603 F.3d at 1308.

80 *Bemont Invs., L.L.C. v. United States*, 679 F.3d 339, 351-55 (5th Cir. 2012) (concurring).

81 See n. 14 on pp. 62-63 of the Brief for the Appellee at Doc. 00512139781 filed on February 8, 2013, in *Irvine, et al.* (5th Cir. 12-20523)

taken without their knowledge and in which they, as limited partners, could not participate. Thirty years after their ill-fated investments, many are now on fixed incomes. While there is no equity in tax law, there is no compelling reason to broadly interpret severe penalties, especially in a procedural setting where the penalized persons have extremely limited and constitutionally doubtful avenues of redress in which to raise defenses to or errors in computational adjustments.

CONCLUSION

Before the Court's jurisdictional question be answered, the test for the jurisdictional character of tax statutes must be determined. *Arbaugh* and *Henderson* establish a broad general test for the jurisdictional character of all federal statutes, unless a specific test applies. There is no specific test for tax statutes. This Court's guidance is needed to clarify that the *Arbaugh*/*Henderson* test applies to tax statutes generally and to §6226 provisions specifically. Under that test, §6226(a)-(g) are jurisdictional and cannot be waived or altered for any tax year subject to TEFRA.

On the facts of this case, §6226(f) did not confer jurisdiction on the district court to determine a §6662 SVM penalty where no relevant partnership-item determinations were made.

If this Court determines the district court did have jurisdiction over the penalty, the denial of the applicability of that penalty should be sustained.

Respectfully submitted.

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INDEX TO ADDENDUMS

Addendum A

The *amici* who are plaintiffs-appellants in *Bush v. United States*, 2013 U.S.App.LEXIS 10879 (Fed. Cir. 2013), where a petition for rehearing is currently pending before the Court of Appeals for the Federal Circuit (Fed.Cir. 12-5051), are:

Gordon W. Bush,
Reola Bush,
Barbara V. Catuzzi,
Lawrence R. Catuzzi,
Gordon R. Cooke,
Jennifer L. Cooke,
Gopala K. Derebail,
Memalatha Derebail,
Albert V. Gude,
Donna C.gude,
Lawrence S. Lewin,
Catherine D. Mcquillan,
Robert V. Mcquillan,
Jeanette T. Nakahara (Deceased),
Kikuo Nakahara,
Leslie A. Spitzack,
Mary C. Spitzack,
Barry S. Strauch, and
Evelyn M. Strauch.

Addendum B

The *amici* who are plaintiffs-appellants in the appeal of *Irvine v. United States*, 2012 U.S. Dist. LEXIS 60083 (S.D. Tex. 2012), currently pending before the Court of Appeals for the Fifth Circuit (5th Cir. 12-20523), are:

John A. Irvine,
Lynda Irvine,
Kenneth L. Kramer,
Billy J. White, and
Ina J. White.

Addendum C

The *amici* who are plaintiffs-appellants in the appeal of *Acute Care Specialists II, Ltd. v. United States*, 2011 U.S. Dist. LEXIS 144155 (N.D. 2011), currently pending before the Court of Appeals for the Seventh Circuit (7th Cir. 12-1212), are:

Acute Care Specialists II, Ltd.,
Gregory W. Jackson,
Nora A. Jackson,
Alan W. Kaplan,
Marcia Kaplan,
Anthony C. Raccuglia,
Judith A. Raccuglia,
Joann Shanahan, and
Joseph Shanahan.

Addendum D

The *amici* who are plaintiffs-appellants in *Fillmore Equip. of Holland, Inc., et. al v. United States*, 2013 U.S. App. LEXIS 12511 (Fed. Cir. 2013), who anticipate that they will shortly file a petition for writ of certiorari in this Court, are:

Fillmore Equipment of Holland, Inc.,
John A. Prag,
Lynn E. Prag,
Donald C. Stecker, and
Elise Stecker.

Addendum E

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SEC. 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL

Except as otherwise provided in this subchapter, the tax treatment of any partnership item shall be determined at the partnership level.

SEC. 6226. JUDICIAL REVIEW OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENTS

(a) PETITION BY TAX MATTERS PARTNER.—Within 90 days after the day on which a notice of a final partnership administrative adjustment is mailed to the tax matters partner, the tax matters partner may file a petition for a readjustment of the partnership items for such taxable year with—

(1) the Tax Court,

(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

(3) the Claims Court.

(b) PETITION BY PARTNER OTHER THAN TAX MATTERS PARTNER—

(1) IN GENERAL.—If the tax matters partner does not file a readjustment petition under subsection (a) with respect to any final partnership administrative adjustment, any notice partner (and any 5-percent group) may, within 60 days after the close of the 90-day period set forth in subsection (a),

file a petition for a readjustment of the partnership items for the taxable year involved with any of the courts described in subsection (a).

(2) PRIORITY OF THE TAX COURT ACTION.—If more than 1 action is brought under paragraph (1) with respect to any partnership for any partnership taxable year, the first such action brought in the Tax Court shall go forward.

(3) PRIORITY OUTSIDE THE TAX COURT.—If more than 1 action is brought under paragraph (1) with respect to any partnership for any taxable year but no such action is brought in the Tax Court, the first such action brought shall go forward.

(4) DISMISSAL OF OTHER ACTIONS.—If an action is brought under paragraph (1) in addition to the action which goes forward under paragraph (2) or (3), such action shall be dismissed.

(5) TAX MATTERS PARTNER MAY INTERVENE. The tax matters partner may intervene in any action brought under this subsection.

(c) PARTNERS TREATED AS PARTIES.—If an action is brought under subsection (a) or (b) with respect to a partnership for any partnership taxable year—

(1) each person who was a partner in such partnership at any time during such year shall be treated as a party to such action, and

(2) the court having jurisdiction of such action shall allow each such person to participate in the action.

(d) PARTNER MUST HAVE INTEREST IN OUTCOME.—

(1) IN ORDER TO BE PARTY TO ACTION.—Subsection (c) shall not apply to a partner after the day on which—

(A) the partnership items of such partner for the partnership taxable year became nonpartnership items by reason of 1 or more of the events described in subsection (b) of §6231, or

(B) the period within which any tax attributable to such partnership items may be assessed against that partner expired.

(2) TO FILE PETITION.—No partner may file a readjustment petition under subsection (b) unless such partner would (after the application of paragraph (1) of this subsection) be treated as a party to the proceeding.

(e) JURISDICTIONAL REQUIREMENT FOR BRINGING ACTION IN DISTRICT COURT OR CLAIMS COURT.—

(1) IN GENERAL.—A readjustment petition under this section may be filed in a district court of the United States or the Claims Court only if the partner filing the petition deposits with the Secretary, on or before the day the petition is filed, the amount by which the tax liability of the partner would be increased if the treatment of partnership items on the partner's return were made consistent with the treatment of partnership items on the partnership return, as adjusted by the final partnership administrative adjustment. In the case

of a petition filed by a 5-percent group, the requirement of the preceding sentence shall apply to each member of the group. The court may by order provide that the jurisdictional requirements of this paragraph are satisfied where there has been a good faith attempt to satisfy such requirements and any shortfall in the amount required to be deposited is timely corrected.

* * * *

(f) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates and the proper allocation of such items among the partners.

(g) DETERMINATION OF COURT REVIEWABLE. Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. With respect to the partnership, only the tax matters partner, a notice partner, or a 5-percent group may seek review of a determination by a court under this section.

(h) EFFECT OF DECISION DISMISSING ACTION. If an action brought under this section is dismissed (other than under paragraph (4) of subsection (b)), the decision of the court dismissing the action shall be considered as its decision that the notice of final partnership administrative adjustment is correct, and

an appropriate order shall be entered in the records of the court.

SEC. 6230. ADDITIONAL ADMINISTRATIVE PROVISIONS

(a) COORDINATION WITH DEFICIENCY PROCEEDINGS.—

(1) IN GENERAL.—Except as provided in paragraph (2), subchapter B of this chapter shall not apply to the assessment or collection of any computational adjustment.

(2) DEFICIENCY PROCEEDINGS TO APPLY IN CERTAIN CASES.—

(A) Subchapter B shall apply to any deficiency attributable to—

(i) affected items which require partner level determinations, or

(ii) items which have become nonpartnership items and are described in §6231(e)(1)(B).

* * * *

(c) CLAIMS ARISING OUT OF ERRONEOUS COMPUTATIONS, ETC.—

(1) IN GENERAL.—A partner may file a claim for refund on the grounds that—

(A) the Secretary erroneously computed any computational adjustment necessary—

(i) to make the partnership items on the partner's return consistent with the treatment of the partnership items on the partnership return . . . .

* * * *

(2) TIME FOR FILING CLAIM.

(A) Under paragraph (1)(A).— Any claim under subparagraph (1)(A) shall be filed within 6 months after the day on which the Secretary mails the notice of computational adjustment to the partner.

* * * *

(3) SUIT IF CLAIM NOT ALLOWED.—If any portion of a claim under paragraph (1) is not allowed, the partner may bring suit with respect to such portion within the period specified in subsection (a) of section 6532 (relating to periods of limitations on refund suits).

(4) NO REVIEW OF SUBSTANTIVE ISSUES. For purposes of any claim or suit under this subsection, the treatment of partnership items on the partnership return, under the settlement, under the final partnership administrative adjustment, or under the decision of the court (whichever is appropriate) shall be conclusive.

* * * *

SEC. 6231. DEFINITIONS AND SPECIAL RULES

(a) DEFINITIONS.—For purposes of this subchapter—

* * * *

(3) PARTNERSHIP ITEM.—The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

(4) NONPARTNERSHIP ITEM.—The term "nonpartnership item" means an item which is (or is treated as) not a partnership item.

(5) AFFECTED ITEM.—The term "affected item" means any item to the extent such item is affected by a partnership item.

(6) COMPUTATIONAL ADJUSTMENT.—The term "computational adjustment" means the change in the tax liability of a partner which properly reflects the treatment under this subchapter of a partnership item. All adjustments required to apply the results of a proceeding with respect to a partnership under this subchapter [63C] to an indirect partner shall be treated as computational adjustments.

* * * *

SEC. 6233. EXTENSION TO ENTITIES FILING PARTNERSHIP RETURNS, ETC.

(a) GENERAL RULE.—If a partnership return is filed by an entity for a taxable year but it is determined that the entity is not a partnership for such year, then, to the extent provided in regulations, the provisions of this subchapter are hereby extended in respect of such year to such entity and its items and to persons holding an interest in such entity.

(b) SIMILAR RULES IN CERTAIN CASES.—If a partnership return is filed for any taxable year but it is determined that there is no entity for such taxable year, to the extent provided in regulations, rules similar to the rules of subsection (a) shall apply.

SEC. 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL

Except as otherwise provided in this subchapter, the tax treatment of any partnership item (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item) shall be determined at the partnership level.

SEC. 6226. JUDICIAL REVIEW OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENTS.

* * * *

(b) PETITION BY PARTNER OTHER THAN TAX MATTERS PARTNER.—

* * * *

(5) TREATMENT OF PREMATURE PETITIONS.—If—

(A) a petition for a readjustment of partnership items for the taxable year involved is filed by a notice partner (or a 5-percent group) during the 90-day period described in subsection (a), and

(B) no action is brought under paragraph (1) during the 60-day period described therein with respect to such taxable year which is not dismissed,

such petition shall be treated for purposes of paragraph (1) as filed on the last day of such 60-day period.

* * * *

(d) PARTNER MUST HAVE INTEREST IN OUTCOME.—

(1) IN ORDER TO BE PARTY TO ACTION.—Subsection (c) shall not apply to a partner after the day on which—

> (A) the partnership items of such partner for the partnership taxable year became nonpartnership items by reason of 1 or more of the events described in subsection (b) of §6231, or (B) the period within which any tax attributable to such partnership items may be assessed against that partner expired.

Notwithstanding subparagraph (B), any person treated under subsection (c) as a party to an action shall be permitted to participate in such action (or file a readjustment petition under subsection (b) or paragraph (2) of this subsection) solely for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired with respect to such person, and the court having jurisdiction of such action shall have jurisdiction to consider such assertion.

(2) TO FILE PETITION.—No partner may file a readjustment petition under subsection (b) unless such partner would (after the application of paragraph (1) of this subsection) be treated as a party to the proceeding.

* * * *

(f) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.

SEC. 6230. ADDITIONAL ADMINISTRATIVE PROVISIONS.

* * * *

(a) COORDINATION WITH DEFICIENCY PROCEEDINGS.—

* * * *

(3) SPECIAL RULE IN CASE OF ASSERTION BY PARTNER'S SPOUSE OF INNOCENT SPOUSE RELIEF.—

* * * *

(B) If the spouse files a petition with the Tax Court pursuant to §6213 with respect to the request for abatement described in subparagraph (A), the Tax Court shall only have jurisdiction pursuant to this section to determine whether the requirements of §6015 have been satisfied. For purposes of such determination, the treatment of partnership

items (and the applicability of any penalties, additions to tax, or additional amounts) under the settlement, the final partnership administrative adjustment, or the decision of the court (whichever is appropriate) that gave rise to the liability in question shall be conclusive.

* * * *

(c) CLAIMS ARISING OUT OF ERRONEOUS COMPUTATIONS, ETC.—

* * * *

(5) RULES FOR SEEKING INNOCENT SPOUSE RELIEF.—

* * * *

(D) PRIOR DETERMINATIONS ARE BINDING.—For purposes of any claim or suit under this paragraph, the treatment of partnership items (and the applicability of any penalties, additions to tax, or additional amounts) under the settlement, the final partnership administrative adjustment, or the decision of the court (whichever is appropriate) that gave rise to the liability in question shall be conclusive.

* * * *

Federal Regulations
Effective for Pre-1990 Tax Years

Treas. Reg. §301.6621-2T. Questions and answers relating to the increased rate of interest on substantial underpayments attributable to certain tax motivated transactions (temporary).

The following questions and answers relate to the increased rate of interest on substantial underpayments attributable to certain tax motivated transactions as provided in section 6621(d) of the Internal Revenue Code of 1954, as added by section 144 of the Tax Reform Act of 1984 (Pub.L. 98-369, 98 Stat. 682):

* * * *

Q-5. How is the amount of a tax motivated underpayment determined?

A-5. Except as provided in A-6 of this section, the amount of a tax motivated underpayment is determined in the following manner:

(1) Calculate the amount of the tax liability for the taxable year as if all items of income, gain, loss, deduction, or credit, had been reported properly on the income tax return of the taxpayer ("total tax liability"); and

(2) Without taking into account any adjustments to items of income, gain, loss, deduction, or credit that are attributable to tax motivated transactions (as defined in A-2 through A-4 of this section), calculate the amount of the tax liability for the taxable year as if all other items of income, gain, loss, deduction, or credit

had been reported properly on the income tax return of the taxpayer ("tax liability without regard to tax motivated transactions").

(3) The difference between the total tax liability and the tax liability without regard to tax motivated transactions is the amount of the tax motivated underpayment.

Example. Taxpayer A, a calendar year taxpayer, files his 1984 income tax return reporting $70,000 of taxable income and $23,171 of tax liability. On January 20, 1986, A enters into a closing agreement with the Internal Revenue Service that includes the following adjustments:

Section 162 deduction disallowed (not tax motivated)	$ 7,500
Loss disallowed under section 465 (tax motivated--see A-2(2) of this section)	$ 5,000
Section 170 deduction disallowed because of a valuation overstatement (tax motivated--see A-2(1) of this section	$10,000
Loss disallowed with respect to a straddle as defined in section 1092 (c) (tax motivated--see A-2(4) of this section	$ 7,000
Other adjustments (none of which are tax motivated)	$ 4,000

The tax motivated underpayment is determined in the following manner:

1.	$ 70,000	reported taxable income
	+ 33,500	(Add all adjustments to items of income, gain, loss, deduction, or credit (including tax motivated transactions subject to section 6621(d)))
	$103,500	Tax = $39,685 ("total tax liability")
2.	$ 70,000	reported taxable income
	+ 11,500	(Add adjustments to items of income, gain, loss, deduction, or credit other than those with respect to items that are tax motivated)
	$ 81,500	tax = $28,691 ("tax liability without regard to tax motivated transactions")

The tax motivated underpayment (*i.e.*, the underpayment attributable to tax motivated transactions) is $10,994 ($39,685–$28,691). Accordingly, the interest on $10,994 would be computed at the 120 percent rate.

The remainder of the underpayment (*i.e.,* the underpayment not attributable to tax motivated transactions) is $5,520 ($28,691 (tax liability without regard to tax motivated items)–$23,171 (tax paid with return)). The interest on $5,520 would be computed at the adjusted rate.